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BEFORE THE ARIZONA CORPORATION COMMISSION

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AZ CORP COMMISSION  
DOCUMENT CONTROL

IN THE MATTER OF QWEST  
CORPORATION'S FILING OF RENEWED  
PRICE REGULATION PLAN.

DOCKET NO. T-01051B-03-0454

IN THE MATTER OF THE  
INVESTIGATION OF THE COST  
OF TELECOMMUNICATIONS  
ACCESS.

DOCKET NO. T-00000D-00-0672

**POST-HEARING BRIEF OF THE RESIDENTIAL UTILITY CONSUMER OFFICE****NON-PROPRIETARY VERSION****I. INTRODUCTION**

The Residential Utility Consumer Office ("RUCO") submits the following points in support of its position that the Arizona Corporation Commission ("ACC" or "Commission") should not approve the Settlement Agreement ("Settlement Agreement", "Settlement" or "Agreement") entered into on April 23, 2005 between Qwest Corporation ("Qwest") the Commission's Utilities Division ("Staff"), MCI, Inc., Time Warner Telecom of Arizona, LLC, the Arizona Utility Investors Association, Cox Arizona Telecom, LLC, and XO Communications Services, Inc., (collectively "the Parties"). The Settlement is not in the public interest and its approval would result in a lost opportunity for the Commission to squarely address the issues that face the telecommunications industry in Arizona as it transitions to competition.

1 The Commission should take advantage of this docket as an opportunity to analyze the  
2 current state of competition in Arizona, and formulate a strategy that addresses the issues that  
3 face Arizona now and in the future. Qwest believes that the Parties - not the Commission -  
4 should decide how to address competition in the telecommunication industry in Arizona.  
5 Transcript at 193-194<sup>1</sup>. RUCO disagrees – RUCO believes that the Commission should  
6 decide how best to address competition in Arizona and that the Commission should make its  
7 decision based on the record before it. The record should contain a comprehensive review of  
8 all the important issues, and not be abbreviated by compromise sought to save time and  
9 resources. No party disputes that competition has intensified in Arizona since the current price  
10 cap plan (“Current Plan”) went into effect in 2001. Given the current state of competition, it is  
11 no longer wise or even appropriate to ignore and/or compromise on the issues that face the  
12 telecommunications industry in Arizona.

13 At least some of the settling Parties view the Settlement as “triage” to a financially ailing  
14 Qwest that fails to reexamine the current state of competition in Arizona or the state of retail  
15 regulation at the present time. See testimony of Walter Meek and Don Price, Transcript at  
16 517-518, 524. The Commission’s view should not be short-sighted – the Commission should  
17 reject the Settlement and send this matter back to hearing for a full and comprehensive review  
18 of competition and retail regulation in Arizona.

19 RUCO believes that a comprehensive review of all the issues will not only result in a  
20 better plan for ratepayers, but will result in a better plan for Qwest. RUCO is not suggesting  
21 that the Settlement is not restrictive enough or provides Qwest with too much pricing flexibility.  
22 On the contrary, RUCO believes that a Commission telecom strategy should provide Qwest

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23  
24 <sup>1</sup> References to testimony at the hearing will be made by identifying the Transcript, followed by the volume  
number, followed by the page number. References will be made to exhibits as they appear in the Transcript of  
Proceedings.

1 with sufficient pricing flexibility to encourage it to behave competitively *in those geographic*  
2 *areas that are now demonstrably competitive*. RUCO is suggesting that the Commission  
3 should adopt a plan that at a minimum, considers the level of competition in each of Qwest's  
4 wire centers, and aligns the pricing flexibility of services offered in those wire centers with the  
5 level of competition Qwest faces in those wire centers.

6 RUCO understands that what it is suggesting will take a substantial amount of time and  
7 effort to achieve: however, it is the best way to assure fair pricing in areas with competition and  
8 prevent Qwest from exploiting its monopoly powers in areas where there is little or no  
9 competition. The Settlement's "one price fits all" approach to pricing services does not, and  
10 cannot, reflect the current competitive environment. The Commission should reject the  
11 Settlement and send this matter back to hearing for a full and comprehensive review.

## 12 13 **THE SETTLEMENT FAILS TO ADDRESS THE MAJOR ISSUES FACING COMPETITION** 14 **AND ITS FUTURE IN ARIZONA**

### 15 **1) GEOGRAPHIC PRICING**

16 The most troubling aspect of the Settlement is not what it addresses, but what it does  
17 not address. The most important issue with regard to competition at this time is the  
18 geographic differences in competition throughout Qwest's service territory. The Settlement  
19 simply turns a blind eye to this issue and provides for a "one price fits all" pricing solution<sup>2</sup>. In  
20 other words, under the Settlement<sup>3</sup> Qwest cannot raise or lower any rates in urban areas  
21 throughout its Arizona service territory without raising or lowering the same rates in rural areas  
22 and vice versa. S-39 at 12. The Settlement ignores the varying degrees of competition that  
23 Qwest faces in its wire centers throughout the State of Arizona. In turn, the Settlement fails to

24 <sup>2</sup> Each service will be placed in a single basket across the state and therefore will be subject to state wide rates.  
S-39 at 12.

<sup>3</sup> This is similar to the way services are priced under the Current Plan.

1 accurately account for the increase in competitive pressure experienced in certain Qwest wire  
2 centers. The Commission should permit greater pricing flexibility for a service in areas where it  
3 is subject to competition, but allow less flexibility in areas where Qwest retains market power.

4 The Company and Staff dismiss the importance of geographic pricing by claiming that  
5 RUCO is overstating the concern and that continued statewide average pricing resolves the  
6 issue, at least for the time being. Q-35 at 20, Q-36 at 8, S-1, S-39 at 12 – 13. As competition  
7 continues to intensify in Arizona, different markets throughout the state experience greater  
8 levels of competition. It no longer makes sense to ignore the increasing competitive disparity  
9 throughout the state and retain mandatory rate averaging. Economists for the most part agree  
10 that rate averaging is not the right approach to geographic pricing in a price cap plan.  
11 Transcript at 401.

12 Rate averaging is a “crude tool” to address geographic pricing in Arizona. Id. at 402.  
13 Rate averaging provides Qwest with little incentive to lower rates in its competitive markets.  
14 Under rate averaging, Qwest will always face a dilemma in areas where it faces competition.  
15 Qwest will initially have to decide whether to maximize its profits by keeping higher prices  
16 everywhere for the short-run, or lower its prices everywhere in hopes of being able to compete.  
17 Id. at 402. Next, Qwest will have to consider the advantage of lowering prices in areas where  
18 it faces little or no competition. Id. It is unlikely that Qwest will ever conclude there is an  
19 advantage to lowering prices in areas where it faces little or no competition. Therefore, the  
20 biggest losers of rate averaging are the customers in the areas where Qwest faces  
21 competition.

22 In areas where Qwest is losing market share, a possible solution would be to lower  
23 prices. However, for the reasons stated above, the Settlement provides Qwest with little  
24 incentive to lower its prices if it must do so statewide. A better solution to address decreasing

1 market share is to recognize that in areas where Qwest faces competitive pressure, the  
2 Commission can loosen the reins of regulation and allow Qwest greater freedom to compete  
3 with other marketplace participants. Id. at 403. Mandatory price averaging has the effect of  
4 constraining Qwest from effectively competing in the competitive market, and in so doing,  
5 prevents the public as a whole from enjoying the benefits of a competitive marketplace. The  
6 Commission should reject the Settlement, and send the issue of geographic pricing back to  
7 hearing for a comprehensive review.

8       The positions advocated by the Company and Staff on the issue of geographic pricing  
9 are, at best, puzzling. The Company, like Staff and RUCO, initially recognized that the issue of  
10 geographic pricing needed to be addressed. In its renewed price cap plan application, the  
11 Company proposed a competitive zone approach similar in "framework" to the one it filed in  
12 1999. Transcript at 70 and 182. The Company withdrew its competitive zone  
13 recommendation as part of the Settlement negotiations and "eliminated" the issue of  
14 geographic pricing for several reasons. First, according to the Company, it was the easy thing  
15 to do. When Qwest filed its renewed price cap plan, it thought that its competitive zone  
16 proposal was the best way to address the competitive market that existed at the time.  
17 Transcript at 67. When Qwest realized that other Parties had taken different positions and  
18 that agreement on this issue would be difficult and require a lengthy and costly process, Qwest  
19 abandoned its competitive zone proposal. Transcript at 66-76. Unfortunately, for the sake of  
20 simplicity and ease, the Settlement simply abandons geographic pricing.

21       Second, the Company, sometime within the past year, appears to have had an  
22 epiphany that "competitive factors have changed" to a level where Qwest's competitive zone  
23 proposal is no longer appropriate. Transcript at 184-189. The Company's witness, David L.  
24 Tietzel filed testimony in December 2004 supporting Qwest's competitive zone proposal. Id. at

1 187-188, However, at the recent hearing, Mr. Tietzel explained a competitive zone proposal is  
2 no longer appropriate due to changing competitive factors. Id. at 189. This logic is flawed as  
3 increasing competitive pressure is the reason the Company, RUCO and Staff initially  
4 recognized that geographic pricing needed to be addressed.

5 Staff's position on geographic pricing is even more puzzling. Originally, Staff was not  
6 opposed to the idea of competitive zones, but opposed Qwest's competitive zone proposal.  
7 Transcript at 308. Staff identified problems it saw with Qwest's competitive zone proposal and  
8 advocated a separate proceeding to address the issue. Transcript at 311. Staff envisioned  
9 two proceedings – one proceeding which would resolve Qwest's proposal for competitive  
10 zones, and another proceeding which would resolve the other issues raised in Qwest's  
11 renewed price cap application. Transcript at 311-312. Since Qwest's competitive zone  
12 proposal was a recommended solution to geographic pricing, and geographic pricing is clearly  
13 one of the most important issues currently facing Arizona, it does not make sense to separate  
14 geographic pricing from consideration of the renewed price cap plan. Resolving the renewed  
15 price cap plan before resolving the geographic pricing issue is putting the cart before the  
16 horse.

17 There are other arguments relating to geographic pricing that have appeared throughout  
18 this docket. One argument that has been suggested minimizes the importance of geographic  
19 pricing under the misinformed belief that Qwest has lost significant market share in Arizona  
20 with the majority of its market share loss in the Phoenix and Tucson areas. **Begin**  
21 **Confidential End Confidential**<sup>4</sup>. This figure clearly indicates that Qwest still enjoys  
22 tremendous market share in Arizona and to minimize the significance of its overall market  
23 share in Arizona because Qwest has been losing revenues would be a mistake.

24 <sup>4</sup> This is based on the most recent data Dr. Ben Johnson has seen and excludes wireless service since most carriers consider wireless service complementary to traditional wire line service – see below. RUCO-11 at 140.

1 docket to the extent it can help foster competition in areas around Arizona where there is little  
2 or no competition. Qwest was the party that originally advocated its relevance in this docket  
3 when it proposed to withdraw \$64 million from the AUSF to defray the high cost of providing  
4 residential service to rural areas. Transcript at 199. Qwest argued that approval of its request  
5 would encourage competition in its high cost centers and promote competitive choices for  
6 these consumers. Transcript at 199. The notion here was that if Qwest were to receive AUSF  
7 support and then lose the customer, that support would be portable (i.e. transfer) to Qwest's  
8 competitors. Id. Qwest did not withdraw its request for AUSF support at any time prior to  
9 entering into the Settlement. Id. at 200. Qwest did, however, negotiate it away as part of the  
10 Settlement. Id. It is disingenuous for any party to now claim it is not relevant to this  
11 proceeding as it was a factor considered in the settlement process.

12       The failure to consider the AUSF in the context of this proceeding is another example of  
13 why this Settlement represents a "lost opportunity" for the Commission to consider and resolve  
14 the issues that face competition in Arizona today. Other states, such as Kansas, have used  
15 Universal Service Funds to help defray the high costs of serving rural areas. RUCO-14 at 20.  
16 The Settlement bargains away any effort to address the high costs of rural lines. In fact, the  
17 Settlement reduces the amount of cost support provided by access charges, thereby making it  
18 even less profitable for competitive local exchange carriers to serve rural areas. Id. The  
19 Commission should send this matter back to hearing to consider cost mechanisms to support  
20 the high costs of rural lines and encourage competition in the rural areas.

1 **THE SETTLEMENT IS NOT IN THE PUBLIC INTEREST**

2           When considering the Settlement, the Commission should determine whether the  
3 Settlement is in the public interest. By comparing the Settlement to the Current Plan, the  
4 Commission can determine whether the Settlement furthers such public policy goals as  
5 establishing and promoting competition in the market, preventing exploitation of Qwest's  
6 monopoly powers and addressing the pricing considerations of rural and urban customers. For  
7 the following reasons, the proposed Settlement does not measure up to the status quo and  
8 should therefore be rejected.  
9

10  
11 **1) FINANCIAL BENEFITS**

12           Under the Current Plan Qwest is subject to a productivity adjustment which provides for  
13 an annual price reduction in Basket 1 services when productivity exceeds inflation.  
14 Productivity is set at a fixed rate of 4.2%, and reductions are made on April 1 of each year.  
15 RUCO-8 at 3. For 2004/2005 Qwest's productivity adjustment would decrease Basket 1 rates  
16 by approximately \$12 million<sup>5</sup>. Id. at 6. The Settlement eliminates the productivity adjustment.  
17 Instead, the Settlement identifies financial benefits totaling approximately \$5.5 million dollars.  
18 S-31 at 9. Those benefits include the following:

- 19           -           Zone charge reductions in zone 1 of \$0.50 which will benefit  
20                               approximately - **Begin Confidential** **End Confidential**. Total benefit  
21                               approximately \$2 million. S-31 at 16.  
22

23  
24 <sup>5</sup> Decision No. 67734 suspended the April 1, 2005 Productivity Adjustment payment. The issue of whether the Settlement credits ratepayers for the full amount of the April 2005 Productivity adjustment will be discussed below.



1 - Reductions in Non-Published and Non-Listed Telephone Number rates  
2 totaling approximately \$2.5 million. Id.

3 - Increase the funding for the medically needy of \$1 million. S-31 at 9.

4 Comparing the financial benefits, ratepayers are better off under the Current Plan. The  
5 Commission should not approve a rate cap plan that renders ratepayers in a worse position  
6 than the status quo.  
7

## 8 9 **2) SERVICE BASKETS AND COMPETITION**

10 Under the Current Plan, services are divided into three baskets: 1) Basic/Essential Non-  
11 competitive services; 2) Wholesale Services; and, 3) Flexibly-Priced Competitive Services. By  
12 comparison, services are divided into four baskets under the Settlement<sup>6</sup> - 1) Hard Capped  
13 Retail Services; 2) Limited Pricing Flexibility Services; 3) Flexibly-Priced Competitive Services;  
14 and, 4) Wholesale Services. RUCO – 14 at 9. For the purposes of Settlement, the Parties  
15 separated into two baskets those services in the current Basket 1 which were hard capped  
16 from those services in Basket 1 that were subject to the 25 percent annual cap on price  
17 increases. S-33 at 4. The Settlement does not adequately align these baskets to reflect  
18 current competitive conditions. Under this basket structure Qwest will be given the opportunity  
19 to exploit its monopoly power in markets where it faces little or no competition. The Settlement  
20 is not in the public interest.

21 In order to understand the basket structure under the Settlement, it is necessary to  
22 consider the criteria the Parties used in determining what services belong to what basket.  
23

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24 <sup>6</sup> RUCO initially proposed the addition of more baskets but in a different manner than the Settlement. RUCO-14 at 10.

1 Specifically, the concern is those services that were hard capped under the Current Plan, and  
2 have been moved to Basket 2 under the Settlement (for example, additional access lines and  
3 PBX trunks) and those services that have been moved from Basket 1 under the Current Plan  
4 to Basket 3 under the Settlement (for example, Home Business Line Service and Stand-by  
5 Line Service). RUCO – 14 at 13. Under the Current Plan, before a service can be determined  
6 “competitive” and moved to Basket 3 it must be determined by the Commission to have met  
7 the requirements of A.A.C. R14-2-1108. RUCO-14 at 9. The Settlement is a negotiated  
8 agreement where each party compromised their respective positions until ultimately the Parties  
9 came up with something that each party could live with. As with any settlement, the Parties  
10 each had different priorities. There can be no doubt that all the Parties did not have the same  
11 interest of making sure those services moved to Basket 3 met the conditions applied by the  
12 Commission in determining a “competitive” service under its Rules. Staff even admits that the  
13 process involved in determining a “competitive” service under the Rules is different than the  
14 process Staff used in the Settlement to determine competitive services. Transcript at 344. It is  
15 imperative that the Commission take a comprehensive review of the criteria used to transfer  
16 services from one basket to another. Should the Commission approve a Settlement that  
17 misapplies competitive status to non-competitive services, it will place Qwest in a position to  
18 exploit its monopoly powers.

19 Staff believes Qwest's ability to apply its monopoly powers to Basket 3 services are  
20 constrained by what Staff believes are adequate safeguards. S-39 at 11. Staff notes that  
21 under the Settlement, services are subject to an individual price cap and an overall revenue  
22 cap of all the services. Transcript at 333. Paragraph 25 of the Settlement provides that Qwest  
23 shall file, within thirty days of the Commission's Order approving the Settlement, a revised  
24 price list containing minimum and maximum ranges for all services contained in Baskets 2 and

1 3. However, this "safeguard" can hardly be considered adequate when neither the Parties,  
2 RUCO nor the Commission will know prior to the approval of the Settlement what the minimum  
3 and maximum prices will be. It is clear from the proposed process that the settling Parties  
4 attach little significance to this list and view it as nothing more than perfunctory. A better  
5 solution would be to assign services to baskets based on the intensity of the competitive  
6 pressures currently faced by Qwest. To the extent competitive conditions vary for some  
7 services across the state, those services would be split into multiple baskets, consistent with  
8 the competitive conditions applicable to each geographic area. RUCO-11 at 168. This  
9 solution will provide adequate safeguards and assure that services are properly aligned with  
10 the degree of competition attributed to each geographic area.

#### 11 12 **THE 2005 PRODUCTIVITY ADJUSTMENT**

13  
14 In Decision No. 67734 the Commission suspended the productivity adjustment that  
15 would have been made on April 1, 2005 under the current price cap plan. The Commission  
16 noted in its Findings of Fact that Qwest has the burden of demonstrating by the terms of a  
17 renewed plan that ratepayers would be given full credit for the value of the April 1, 2005  
18 productivity adjustment. Decision No. 67734 at page 8. Qwest has failed to meet its burden  
19 as set forth in Decision No. 67734. The Parties claim that Qwest's obligation is satisfied by  
20 the Settlement's \$12 million reduction in its allowable net increased revenues for the first year  
21 of the renewed Plan. S -1 at 5. However, in the absence of Decision No. 67734, ratepayers  
22 would have enjoyed real rate cuts of approximately \$8 million to date. RUCO - 8 at 6. By April  
23 1, 2006, ratepayers would have enjoyed rate decreases of the full \$12 million under the  
24 Current Plan. Thus ratepayers would have been put in a better position than they had been

1 prior to the April 1, 2005 adjustment. Id. The Settlement merely restricts the amount that  
2 Qwest can raise prices in Basket 2. The Settlement does not put money back in ratepayer's  
3 pockets and/or provide a dollar for dollar benefit in lieu of the 2005 adjustment.

4 A better solution would be to provide Qwest's 1FR and 1FB customers with a monthly  
5 credit on their bills equal to a twelve-month amortization of the value of the productivity  
6 adjustment that was foregone during the suspension period. Id. While there may be other  
7 alternatives that the Commission can consider, at a minimum, ratepayers should get full credit  
8 for the April 1, 2005 productivity adjustment. The Commission should reject the Settlement  
9 and send this matter back to hearing for a full and comprehensive hearing.


## 11 **CONCLUSION**

12 The Settlement is not in the public interest. It fails to address the major issues that face  
13 the telecommunications industry in Arizona – geographic pricing and competition in areas  
14 where Qwest faces little or no competition. Moreover, the Settlement is a quick fix or triage for  
15 a financially ailing company losing revenues, and not a comprehensive and strategic long term  
16 plan designed to effectively facilitate Arizona's transition towards competition.

17 Finally, the Settlement itself renders ratepayers in a worse position than under the  
18 Current Plan, and it fails to adequately provide customers with the full value of the 2005  
19 productivity adjustment. The Commission should reject the Settlement and send this matter  
20 back to hearing for a comprehensive review and determination of all the issues.

1 RESPECTFULLY SUBMITTED this 2nd day of December, 2005.

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Note: Confidential Versions are being  
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RUCO-11

SCHEDULES 4 AND 5

ARE REDACTED